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TAGS: ETRD ECON ECIN XG TS
SUBJECT: EU ASSOCIATION AGREEMENT DEMONSTRATES BENEFITS OF
FREE TRADE

Summary

¶1. (SBU) With the first phase of the EU Association Agreement in effect, both the EU and the GOT are largely satisfied with the results. On January 1, Tunisia eliminated tariffs on manufactured goods -- one year ahead of schedule. Aside from the protracted negotiations on processed agricultural goods and pharmaceutical IPR concerns, the European Commission tells us tariff dismantlement has gone smoothly. Many Tunisians feared an influx of European goods and widespread company closures, but neither have come to pass. Tunisia's trade deficit with the EU has actually decreased as tariffs were progressively dismantled, reflecting the gains from free trade. Even as the Association Agreement and a soon-to-be-released World Bank study demonstrate the positive economic impact of trade liberalization, the GOT is taking its time in pursuing further liberalization. EU negotiations on agricultural liberalization are moving slowly and discussions on scheduling services liberalization have not even begun. End Summary.

Round One: Manufactured Goods

¶2. (SBU) On January 1, Tunisia eliminated tariffs on manufactured goods as part of the first phase of the Association Agreement signed with the European Union in 1995. Tariffs on these products have been progressively dismantled over a period of more than ten years. Fabian Seiderer, Macroeconomist at the European Commission, stated that for the most part the dismantling of tariffs had gone smoothly and that the GOT had actually implemented the elimination one year ahead of schedule. The GOT decided to advance tariff reductions because investment in the manufacturing sector began to slow, with many companies taking a "wait and see" approach. He recounted, however, that there had been problems with processed agricultural products and pharmaceuticals. Negotiations on tariff reductions for processed agricultural products were not completed until the very end of 2007, with implementation delayed for several years. Seiderer highlighted that EU pharmaceutical companies had shared many of the same IPR concerns as US firms, particularly in regard to the "correlation" system. (Note: Pharmaceuticals could not be imported if there was a locally produced equivalent, even if generic.) He indicated that the December 2006 end of "correlation" appeared to alleviate this

concern. Habib Guida, Director General at the Tunisian-French Chamber of Commerce and Industry, complained that in eliminating customs tariffs the GOT had raised the value-added tax. Seiderer remarked that although this was true it was non-discriminatory and could also be seen as a way for the GOT to recoup the fiscal loss from the absence of customs.

Productivity Up

¶3. (SBU) Although many Tunisians feared the agreement would lead to widespread company closures and job loss, the impact has been extremely positive. Tunisia's trade deficit with the EU has actually decreased. From 2003 to 2007, Tunisia's exports to the EU have increased from 8.7 million dinars (US $7.4 million) to 16 million (US $13.6 million). In 2007, Tunisia's trade deficit with the EU narrowed nearly 13 percent over 2006. Seiderer emphasized that the agreement has helped to demonstrate the positive benefits of free trade. Guida stated that Tunisian companies have become more competitive. The GOT places great stress on the success of its "mise-a-niveau" program to upgrade Tunisian companies. He argued that the efficiency gains were not the result of the "mise-a-niveau" program. Instead, this represented the first time many companies seriously evaluated their competitiveness -- from adopting new production technologies to examining pricing and profit structure. While Guida and Seiderer acknowledged that some Tunisian companies have gone out of business, they both argued that these companies would have failed anyway because they were simply not profitable. A World Bank (WB) study that has not yet been publicly

released, confirms that the sectors that are the most open are the most productive. The report shows that productivity in the manufacturing sector has gone up and has been accompanied by a significant increase in FDI to the sector.

No New Goods

¶4. (SBU) Despite the fanfare surrounding the elimination of tariffs on January 1, the Tunisian market has yet to witness an influx of new European products. Seiderer remarked that there had been an increase in some consumer goods, but noted that the strong euro made imports particularly expensive at the moment. In the past several years there has also been a shift away from sourcing goods from Europe, with Tunisian manufacturers importing materials from countries such as Turkey. Additionally, a high proportion of EU-Tunisian trade has been with Tunisia's offshore sector rather than the domestic market. In response to laments about the continued absence of European cheeses and wines, Seiderer highlighted that tariffs for many of these products should be reduced in the coming years as part of the now completed negotiations on processed agricultural goods.

Round Two?

¶5. (SBU) Seiderer noted that although the EU and GOT have technically begun negotiating agriculture, the GOT is "dragging its feet." He believed that the GOT agreed to start negotiations merely due to the optics of being among the last countries to start discussions. Since the World Bank is currently working with the Ministry of Agriculture to develop a new strategy for the sector, he admitted this might explain the lack of action. On services liberalization, Seiderer stressed that the GOT has not begun to negotiate and has not even discussed scheduling negotiations. He stated that services are still technically scheduled to be liberalized by 2010, but that the EU does not expect this

timeline to be met. Seiderer lamented that the GOT continues to demand extensive external financing and often complains that the EU is not providing enough in the way of funding. He complained that the GOT expects the EU to fund upgrades for each sector that is liberalized as compensation.

Comment

¶6. (SBU) In many ways, Tunisia's Association Agreement with the EU represents a trial balloon for further trade liberalization. The agreement and the soon-to-be-released WB report demonstrate that liberalization yields positive results for Tunisian economic performance. The strong performance of Tunisia's offshore sector provides additional evidence. While we would hope that these successes would spur greater and faster liberalization, the GOT has long favored a cautious, go-slow approach. The GOT's foot dragging on EU negotiations indicates they have not abandoned their traditional strategy. Regardless of the pace, the GOT is headed in the right direction -- more, rather than less, liberalization.

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